No. 89-475

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,
Petitioner,

v.

PHILIP D. ROBERTS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER PEAT MARWICK MAIN & CO.

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QUESTIONS PRESENTED

The Institute fully supports each of the arguments made by Peat Marwick in its Petition and incorporates those arguments as if fully set forth herein. In the interest of brevity, this brief focuses on the issue that has in the past been specifically reserved by this Court and that is of overriding significance to the accounting profession, namely:

Whether there exists an implied private right of action for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 promulgated thereunder.

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER PEAT MARWICK MAIN & CO.

PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae*, pursuant to Rule 36.1 of the Rules of this Court, in support of petitioner Peat Marwick Main & Co. ("Peat Marwick").[1]

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national organization of the certified public accounting profession, with more than 280,000 active members located in each of the fifty states. Among the Institute's objectives are the promotion and maintenance of accounting, auditing, and ethical standards of practice. As the authoritative source of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on accountants in connection with their professional services under the rubric of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988) ("Section 10(b)" and the "1934 Act") and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1988) ("Rule 10b-5") promulgated thereunder.

The issues involved in this case transcend the interests of the parties and are of particular importance to the Institute and its members. The decision of the United States Court of Appeals for the Ninth Circuit establishes an extreme theory of accountants' liability for aiding and abetting violations of Section 10(b) and Rule 10b-5. Under the lower court's reasoning, the mere mention in an offering memorandum of an accounting firm's agreement to perform future services, together with a general

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[1] This brief is submitted on consent of the parties. The written consents of Petitioner and Respondents are being filed with the Clerk of the Court contemporaneously herewith.

averment of knowledge of material misstatements in the memorandum, may subject the firm to liability for aiding and abetting—even though the reference to the accounting firm is truthful and the firm has not otherwise made any statement or representation about the prospective investment. This holding demonstrates the uncontrolled expansion of secondary liability for accountants and other professional service providers that has occurred as the lower courts have struggled to apply common law concepts of aiding and abetting to securities fraud cases.

STATEMENT OF THE CASE

Petitioner, Peat Marwick, was one of over 100 defendants named in a class action complaint filed in the United States District Court for the Northern District of California. The plaintiff class is comprised of investors in thirty-nine oil and gas limited partnerships sold as potential tax shelters between 1979 and 1983 by three separate partnership groups (Complaint ¶ 12). When certain oil technologies that were purportedly crucial to the partnerships' success failed to materialize, the investors brought suit under Section 10(b) and Rule 10b-5, alleging fraud in the sale of the partnership interests. Plaintiffs claimed that the partnerships had failed to disclose, *inter alia*, material information about certain oil recovery technology in the memoranda used to sell the investments (Complaint ¶ 40).

Plaintiffs specifically charged Peat Marwick with primary violations of Section 10(b) on the basis of post-investment audit reports and tax forms it had prepared. They also charged Peat Marwick with aiding and abetting the partnerships' violations of Section 10(b) by "participating" in the preparation of the selling memoranda with "knowledge" of its falsity. The only fact claimed in support of this conclusory allegation was a single truthful statement contained in the offering documents that "Peat, Marwick, Mitchell & Co., Denver, Colorado has agreed to perform accounting services for the Partnership, includ-

ing the preparation of tax returns and audited financial statements" (Complaint ¶ 43(b)).

The district court granted summary judgment in favor of Peat Marwick on plaintiffs' Section 10(b) claim, finding that plaintiffs could not recover "based on financial reports issued after plaintiffs [had] purchased their units." *Roberts v. Heim*, 670 F. Supp. 1466, 1481 (N.D. Cal. 1987) (Pet. 40a). That court also dismissed plaintiffs' aiding and abetting claims against Peat Marwick with prejudice. After noting that the claim rested solely on the true statement that Peat Marwick would "provide accounting services in the future," the District Court refused to "expand the scope of § 10(b) liability to encompass professionals whose involvement in the perpetration of the alleged fraud was merely agreeing to provide professional services in the future." *Id.* at 1482 (Pet. 42a).

The Ninth Circuit affirmed summary judgment on plaintiffs' Section 10(b) claims. *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 649-52 (9th Cir. 1988) (Pet. 8a-13a). It reversed dismissal of the aiding and abetting count, however, holding that the "investors have alleged that Peat, Marwick knew of the alleged violation but allowed the use of its name in offering memoranda despite that knowledge. These facts may be sufficient to create a duty to disclose in Peat, Marwick." *Id.* at 653 (Pet. 14a). The court explained its ruling as follows:

> Investors can reasonably be expected to assume that an accounting firm would not consent to the use of its name on reports and offering memoranda it knew were fraudulent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation, where the accountant's information is superior and the cost to the accountant of disclosure is minimal. [*Id.* (citations omitted) (Pet. 14a).]

SUMMARY OF ARGUMENT

This Court has repeatedly held, in various contexts, that the existence *vel non* of a statutory cause of action under Section 10(b), as well as its scope and elements, are a question of Congressional intent. The Ninth Circuit has simply ignored this precedent in its decision below, relying instead on common law concepts of aiding and abetting to impose expansive liability under the statute against accountants and other professionals. Such reliance is, in the words of this Court, "entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979). Even a brief analysis of the language and legislative history of Section 10(b) strongly suggests that Congress never intended to expand the scope of liability under the statute to aiding and abetting, choosing instead to address such conduct through a number of express civil remedies.

Moreover, this Court has consistently rejected similar efforts to expand the scope of liability under Section 10(b) to conduct that is not itself proscribed by the statute. Most notably, this Court's holding in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), firmly established that the "manipulative or deceptive" language of Section 10(b) embraces intentional conduct only, thus requiring a showing of scienter on the part of the defendant. The decision below, in complete disregard of that limitation, expands the scope of liability to persons who have not engaged in a manipulative or deceptive practice within the meaning of Section 10(b). If permitted to stand, the lower court's decision portends an uncharted, potentially limitless, expansion of secondary liability under Section 10(b).

Finally, the Ninth Circuit and other lower courts have made no effort to consider or analyze the far-reaching impact that private actions for aiding and abetting are having on both the federal statutory disclosure scheme and on the availability and costs of accounting and other professional services. By requiring accountants and other

professionals to vouch for the accuracy of offering documents—even where the substance of those documents is beyond their expertise or control—the Ninth Circuit has encouraged investment decisions on the basis of an inferred endorsement, rather than a careful review of the comprehensive disclosures of management required under the federal securities laws. The Ninth Circuit's reasoning also permits the remotest of connections to an alleged fraud to be used by plaintiffs' counsel to ensnare accountants and other professionals in costly and vexatious litigation. The increasing costs and burdens of defense result in fewer and more expensive transactions, and disrupt the provision of accounting and other professional services to businesses, including new and speculative ventures that are vital to the growth of the economy.

The Petition of Peat Marwick provides this Court with the opportunity to resolve the important federal questions of law and policy posed by the existence *vel non* of an implied right of action for aiding and abetting under Section 10(b). The Ninth Circuit's decision, which expands the scope of actionable conduct under this court-made right to new extremes, demonstrates the risks of any further unguided jurisprudence on these issues.

ARGUMENT

THIS COURT SHOULD SETTLE THE IMPORTANT QUESTION OF WHETHER AN IMPLIED PRIVATE ACTION EXISTS FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) OF THE 1934 ACT AND RULE 10b-5 PROMULGATED THEREUNDER.

This Court is again called upon to define the permissible scope of implied private causes of action under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. The Petition of Peat Marwick provides this Court with an opportunity to address two significant questions of federal law that it has previously reserved: (1) "whether civil liability for aiding and abetting is appropriate" under Section 10(b) and Rule 10b-5; and (2) if so, "the elements necessary to establish

such a cause of action." *Ernst & Ernst*, 425 U.S. at 191-192 n.7; *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 376 n.5 (1983).

In the absence of a definitive ruling from this Court on these issues, federal trial and appellate courts have attempted to answer these important questions of federal statutory construction by an unprincipled application of concepts of aiding and abetting derived from the common law of torts and nowhere found in the statute. The result of this unguided effort has been a confused and unwarranted explosion of secondary liability under Section 10(b).[2]

A. Principles Of Statutory Construction Preclude The Imputation Of An Implied Right Of Action Where, As Here, It Is Inconsistent With The Statutory Text And Scheme.

The existence *vel non* of a statutory cause of action under Section 10(b), as well as its scope and elements, are a question of statutory construction. *See Touche Ross & Co. v. Redington*, 442 U.S. at 568. As emphasized by this Court, the " 'fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person.' " *Id.* at 568 (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 688 (1979)). Rather, "[t]he ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.* at 578. In accordance with that injunction, this Court has refused to permit reliance on tort or common law principles as a justification for imputing private remedies: "[The] central inquiry [is] whether Congress intended to create, either expressly or by implication, a private cause of action." *Id.* at 575. *See also Transamerica Mortgage Advisors, Inc. v. Lewis*, 444

[2] An extensive discussion of the split of authority that has arisen among the Circuits on this issue is set forth in Peat Marwick's Petition at 13-19.

U.S. 11, 24 (1979) (the "dispositive question" is whether Congress intended to create a private cause of action).

While this Court has identified several factors in considering whether an implied private action exists under the federal securities laws,[3] the most critical and decisive issue is the legislative intent. *Touche Ross & Co. v. Redington*, 442 U.S. at 578.[4] Thus, any private right analysis necessarily begins with "the language and focus of the statute, its legislative history, and its purpose . . . ." *Id.* at 575-76. Where "the statute by its terms grants no private rights to any identifiable class . . . [and] the legislative history of the 1934 Act . . . does not speak to the issue . . . the inquiry ends there: The question whether Congress, either expressly or by implication, intended to create a private right of action, has been definitely answered in the negative." *Id.* at 576.

Despite this Court's clear instruction that legislative intent controls, the lower federal courts have made no effort to discern whether Congress intended to create an implied right of action for aiding and abetting under Section 10(b). *See* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. 80, 94 (1981) (lower courts have made "no attempt . . . to justify secondary liability by reference to the language of section 10(b), the statutory framework, or

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[3] The four criteria set forth in *Cort v. Ash*, 422 U.S. 66, 78 (1975), have been widely used in determining the existence *vel non* of an implied private action under the securities laws. While this brief does not permit a discussion of each of these factors (and, as noted hereinabove, a full analysis may not be necessary once Congressional intent has been discerned), the Institute is prepared to show that none of them supports a private action for aiding and abetting under Section 10(b).

[4] *See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 358 (1982) (no need to "trudge through all four of the factors when the dispositive question of legislative intent has been resolved"); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. at 24 ("[t]he dispositive question remains whether Congress intended to create any such remedy").

relevant legislative history"). Rather, the courts have independently adopted common law concepts of aiding and abetting to support private actions under the statute.

Such reliance on unrelated common law to determine an issue of Congressional intent is "entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. at 568. The Ninth Circuit's decision here provides the most recent and dramatic illustration of the lower courts' blind foray into this area of secondary liability. Without even a passing reference to the text of the 1934 Act, to the statutory framework or to Congressional intent, the court below has expanded the scope of liability under an implied right of action for aiding and abetting to reach conduct that is not proscribed by or otherwise actionable under Section 10(b). This result finds no warrant in either the language or legislative history of the statute.

1. *The Statutory Text And Scheme Do Not Support An Implied Right Of Action.*

Section 10(b) provides that "[i]t shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . . ." Neither the statute itself nor Rule 10b-5 contains any express provision making it unlawful to aid and abet violations of Section 10(b). The absence of any express statutory language for aiding and abetting "is strong evidence that Congress did not intend to impose such liability upon conduct which would not otherwise be prohibited as a 'manipulative or deceptive practice.'" Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. at 95.

In contrast, Congress has provided explicit statutory authority for administrative and criminal enforcement actions against aiders and abettors in other provisions of the federal securities laws.[5] Moreover, Section 15 of the

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[5] For example, Section 15(b)(4)(E) of the 1934 Act authorizes the SEC to discipline a broker or dealer for aiding and abetting violations of the securities laws. Similarly, Sections 15(b)(1) and

1933 Act (15 U.S.C. § 77o (1988)) and Section 20(a) of the 1934 Act (15 U.S.C. § 78t (1988)) impose secondary liability on "controlling persons," provided they have not acted in good faith. Section 11 of the 1933 Act (15 U.S.C. § 77k (1988)) also imposes liability on, and grants defenses for, various nonprivity parties, such as accountants, underwriters, and other experts, for specified conduct relating to the preparation of registration statements; however, as to an accountant, this liability explicitly only extends to a statement which purports to have been "prepared or certified" by him, not to the remainder of the prospectus. Section 11(a)(4) (15 U.S.C. § 77k(a)(4) (1988)).

The express imposition of limited secondary liability under these provisions is highly significant in discerning Congressional intent: It demonstrates, in the words of this Court, that when Congress intended to impose such liability, "'it had little trouble doing so expressly.'" *Touche Ross & Co. v. Redington*, 442 U.S. at 572 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 734 (1975)). Taken in conjunction with the fact that no express provision is made for private rights of action for aiding and abetting, a strong implication is raised that Congress knowingly and deliberately omitted such rights from the legislative scheme.

(b)(6) incorporate by reference all of Section 15(b)(4), thereby authorizing the SEC to deny registration to brokers or dealers who aid and abet violations, and to bar aiders and abettors from association with a broker or dealer. The SEC also has authority to discipline investment advisers and companies that aid and abet securities laws violations. *See* 15 U.S.C. §§ 80b-3(e)(5) (1988), 80a-9(b)(3) (1988), and 80b-9(d) (1988). SEC Rule of Practice 2(e), 17 C.F.R. § 201.2(e)(1)(iii), (3)(i) (1988), further authorizes the Commission to deny the right to practice before it to aiders and abettors.

2. *The Legislative History Of Section 10(b) Strongly Suggests That Congress Did Not Intend To Provide A Private Right Of Action Thereunder For Aiding And Abetting.*

The legislative history of Section 10(b) and other pertinent provisions of the 1934 Act reinforces the negative implication against private actions for aiding and abetting. There is no evidence in the legislative history of Section 10(b) that Congress ever intended to impose liability for aiding and abetting a primary violator. Moreover, in contrast to the subject of whether there is a private right of action for a primary violation of Section 10(b)—on which the legislative history is simply silent—the legislative history speaks clearly on the subject of secondary liability for aiding and abetting: Congress has specifically rejected attempts to amend the federal securities laws expressly to prohibit the aiding and abetting of violations of Section 10(b). In 1959, legislation was introduced that would have made it unlawful 'for any person to aid [or] abet . . . the violation of any provision of [the 1934 Act] or rule or regulation thereunder."[6] During deliberations on the amendment, industry representatives raised the expressed fear that it would result in aiders and abettors being liable for damages in private suits—prompting the SEC to agree to a clarification of the bill to indicate that "no civil liability is intended."[7] The bill, in any event, was never enacted. When language subjecting aiders and abettors to the SEC's injunctive powers was introduced the next year, it also failed.[8]

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[6] H.R. 5001 and S. 1178, 86th Cong., 1st Sess. (1959), reprinted in *Securities Acts Amendments, 1959: Hearings on H.R. 5001 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 89, 103 (1959).

[7] *SEC Legislation: Hearings Before A Subcomm. of the Senate Comm. on Banking and Currency on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 86th Cong., 1st Sess. 288, 292 (1959).

[8] *See* S. 3770, § 20, 86th Cong., 2d Sess., 106 Cong. Rec. 15,613, 15,614 (1960); S. Rep. No. 1757, 86th Cong., 2d Sess. (1960).

Moreover, Congress has successively amended Section 15(b)(4)(E) of the 1934 Act, which contains express enforcement provisions against aiders and abettors, without ever mentioning, much less adopting, any private rights of action. *See* 15 U.S.C. § 78o(b)(4)(E) (1988). This longstanding inaction, coupled with Congress's explicit rejection of efforts to amend the securities laws to include express private rights of action for aiding and abetting, appears to confirm that Congress has never intended to bring such conduct within the scope of the federal securities laws. *See Flood v. Kuhn*, 407 U.S. 258, 273-74 (1972) (Congress's repeated failure to amend antitrust laws to make them applicable to baseball indicates a Congressional intent that baseball remain exempt from those laws).

A summary review of the language and legislative history of Section 10(b), therefore, raises serious doubt that Congress intended to create private actions for aiding and abetting. Thus, while the Ninth Circuit and other lower federal courts have been quick to embrace such a right based on concepts borrowed from the common law of torts, the fundamental question of whether an implied private action for aiding and abetting exists under Section 10(b) has yet to be answered. The Petition of Peat Marwick provides this Court with an opportunity to address that important federal question and to provide much needed guidance to both the lower courts and to the investing public.

B. The Ninth Circuit Decision Conflicts With This Court's Repeated Efforts To Confine Liability Under Section 10(b) To Conduct Actually Proscribed By The Text Of The Statute.

The Ninth Circuit's adoption of common law concepts of aiding and abetting for use in the securities laws, besides lacking any apparent basis in congressional intent, directly conflicts with applicable decisions of this Court. While this Court has recognized an implied right of action for primary violations of Section 10(b), it has explicitly and repeatedly rejected any expansion of the

scope of actionable conduct beyond that statutorily proscribed by Congress.

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court reversed a finding by the Seventh Circuit that an accounting firm's negligent failure to uncover fraud on the part of the primary violator could subject it to liability as an aider and abettor. While reserving the question of whether an implied right of action for aiding and abetting exists under Section 10(b) (*id.* at 191-192 n.7), this Court held that the Seventh Circuit's decision constituted an unwarranted expansion of liability under the statute. Specifically, the Court found that the "manipulative or deceptive" language of Section 10(b) embraces intentional conduct only, thus requiring a showing of scienter on the part of the defendant. *Id.* at 200-202; 212.[9] While *Ernst & Ernst* does not explicitly deny the existence of an implied private action for aiding and abetting, therefore, it does hold—at a minimum—that a particular defendant's conduct is actionable only where it meets the test of "manipulative or deceptive."

This ruling casts serious doubt on the viability of implied private actions for aiding and abetting. As explained by one commentator:

> [U]nder a strict aiding and abetting analysis, it is irrelevant whether an aider and abettor has engaged in a manipulative or deceptive practice within the meaning of Section 10(b). What is relevant is

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[9] This Court's restrictive reading of the substantive scope of Section 10(b) has continued in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74 (1977) (language of § 10(b) "gives no indication that Congress meant to prohibit any conduct . . . [that cannot] be fairly viewed as 'manipulative or deceptive' within the meaning of the statute"); *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) (The 1934 Act "cannot be read 'more broadly than its language and the statutory scheme reasonably permit.' [S]ection 10(b) is aptly described as a catchall provision, but what it catches must be fraud"); and *Herman & MacLean v. Huddleston*, 459 U.S. at 382 ("a § 10(b) plaintiff carries a heavier burden . . . [m]ost significantly, he must prove that the defendant acted with scienter, i.e., with intent to deceive, manipulate, or defraud").

> whether the *primary violator* engaged in such a practice. The critical inquiry then would be whether the secondary defendant aided and abetted in the commission of the violation.

Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. at 88 (emphasis in original). By refusing to extend liability to the accounting firm because it had not engaged in a "manipulative or deceptive" practice, and by not separately considering whether an independent claim could be made against the firm for aiding and abetting, the decision in *Ernst & Ernst* suggests that aiding and abetting liability does not exist under Section 10(b); or, at the very least, that such liability extends only to conduct that is itself an express violation of the provision.[10]

In adopting common law concepts of aiding and abetting for use in Section 10(b) cases, however, the lower federal courts have largely ignored the "manipulative or deceptive" limitation required by the statute and this Court. The Ninth Circuit's decision here not only ignores this limitation, but directly contradicts it: The lower court expressly held that the respondents could *not* state a claim for a primary violation against Peat Marwick on the facts of the case. Thus, there is no allegation re-

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[10] At least one district court has read the *Ernst & Ernst* decision implicitly to hold that there is no private right of action for aiding and abetting:

> It is . . . doubtful that a claim for "aiding and abetting" or "conspiracy" will continue to exist under 10(b). The Court did not reach this issue in *Ernst*, but its statement that intent is necessary to state a claim under 10(b) implicitly holds that aiding and abetting liability will not exist apart from liability for a direct violation. Recent commentary supports this view. This is also further supported by decisions which hold that liability under 10(b) is solely a question of Congressional intent. Reliance on tort law principles for implying a right of action under the Securities Act is "entirely misplaced."

Benoay v. Decker, 517 F. Supp. 490, 495 (E.D. Mich. 1981), *aff'd without published opinion*, 735 F.2d 1363 (6th Cir. 1984) (citations omitted).

maining that Peat Marwick itself engaged in a manipulative or deceptive act, as required under the principle of law stated in *Ernst & Ernst*. The Ninth Circuit concluded, nonetheless, that Peat Marwick might be proven liable as an aider and abettor, declaring—without legal authority or statutory analysis—that "[a]iding and abetting is itself a violation of Section 10(b) and Rule 10b-5." *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d at 653 (Pet. 14a).

In short, the lower court has reached the same result that this Court rejected in *Ernst & Ernst*; namely, it has adopted a rule of law that imposes liability for conduct that does not itself satisfy the statutorily derived elements of a primary violation. Those elements were carefully drawn by Congress in measuring the scope of liability under Section 10(b), and this Court has faithfully adhered to them in defining the contours of private actions brought under the statute. Having now freed an implied right of action for aiding and abetting from these statutory moorings, the Ninth Circuit's decision portends an uncharted, potentially limitless, expansion of secondary liability under Section 10(b). The risks of such unguided potential liability compel the attention of this Court.

C. Recognition Of Implied Private Actions For Aiding And Abetting Imposes Unlimited Potential Liability And Will Disrupt The Provision Of Accounting And Other Professional Services To The Public.

Finally, the Ninth Circuit's recognition of an implied private action for aiding and abetting poses serious policy considerations that have never been addressed by this Court. While only a brief discussion of those issues is permitted here, the Institute is prepared to show that the existence of such an implied right subverts elemental principles of the federal securities laws and allows imposition of the sort of speculative liability that this Court has previously condemned. The potential consequences of such an extension of secondary liability on professional

service providers are profoundly disturbing and demonstrate that such a rule is improvident.

1. *An Implied Private Action For Aiding And Abetting Undermines The Federal Statutory Disclosure Scheme.*

The 1933 Act was designed, *inter alia*, "to provide investors with full disclosure of material information concerning public offerings of securities . . . ." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 195 (citations omitted). The federal statutory disclosure scheme is premised on the principle that management is in the best position to make full disclosure of material facts regarding its business operations. This principle is reflected in the express remedies created by Congress under the Act, which impose virtually absolute liability against the issuer of a security, while creating higher standards of liability and defenses for other enumerated parties, including accountants, who have only assisted in the preparation of certain portions of a registration statement. *See* 15 U.S.C. § 77k(b) (1988). Recognition of broad secondary liability under Section 10(b) subverts this Congressional calculus by permitting management to shift liability to its accountants, underwriters, and other professional service providers, thereby reducing management's incentive to make full and accurate disclosure. Schy, *Privity and Accountants' Liability*, 16 Sec. Reg. L. J. 54, 63 (1988).

The Ninth Circuit's decision here offers further evidence of how increasingly expansive secondary liability under Section 10(b) undermines the federal statutory disclosure scheme. The lower court's assumption that an accounting firm "would not consent to the use of its name" on false reports elevates status over conduct in a manner that is both confusing to the investing public and unfair to professionals. First, this assumption completely disregards the role and purpose of an accountant. Certified Public Accountants are typically engaged to audit and report on the financial statements of a company through the application of detailed rules and stand-

ards, many of which were developed by the Institute. The investing public relies on auditors to review and report on financial statements consistent with these professional standards. It should not expect accountants to render reports on aspects of a company's business that they were not retained to review and over which they may have neither the expertise nor the access to information necessary to form a valid opinion. Thus, the Ninth Circuit's presumption that the plaintiffs here could have reasonably relied upon Peat Marwick, at a time before it had performed any services or issued any report, to discover, evaluate, and disclose the partnerships' alleged misrepresentations about certain oil recovery technology is entirely unreasonable.

Second, this type of presumption wrongly suggests to investors that they may disregard the substance of offering documents and rely on the mere mention of a reputable accounting firm or other professional organization in offering documents as proof-positive that the investment is sound. By encouraging investment decisions on the basis of an inferred endorsement, rather than a careful review of actual disclosures, the Ninth Circuit's decision effectively supplants the purpose and operation of the federal securities disclosure laws.

2. *The Drastic Expansion Of Secondary Liability Threatens To Disrupt The Provision Of Accounting And Other Professional Services.*

The unguided adoption of aiding and abetting liability under Section 10(b) by the lower federal courts has significantly broadened the number of cases where plaintiffs may seek to impose liability on accountants and other experts. The federal reporters increasingly abound with cases in which accountants have been required to defend against claims of aiding and abetting a violation of Section 10(b) through costly discovery or trial.[11] These re-

[11] Those cases include the following: *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566 (2d Cir.), *cert. denied*, 459

ported cases are, of course, only the visible tip of a much larger bulk of cases working their way through the courts. This flood of cases can be expected to swell significantly under the Ninth Circuit's decision, which signals to plaintiffs' counsel that even the remotest connection to an alleged fraud may be sufficient to draw accountants and other "deep pocket" service providers into burdensome litigation. Moreover, by effectively precluding dismissal under Fed. R. Civ. P. 12(b) in cases where some "knowledge" of the alleged fraud is averred, the ruling will greatly increase the costs of defense for accountants and other professionals, who will be required to defend against conclusory allegations of aiding and abetting at least through the discovery and summary judgment phases of the litigation.[12]

U.S. 838, *cert. denied*, 459 U.S. 908 (1982); *Rosen v. Dick*, 639 F.2d 82 (2d Cir. 1980); *National Union Fire Ins. Co. v. Cooper*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,452 (S.D.N.Y. April 18, 1989); *TCF Banking and Sav., F.A. v. Arthur Young & Co.*, 706 F. Supp. 1408 (D. Minn. 1988); *Bernstein v. Crazy Eddie, Inc.*, 702 F. Supp. 962 (E.D.N.Y. 1988); *In re Union Carbide Corp. Consumer Prods. Business Sec. Litig.*, 676 F. Supp. 458 (S.D.N.Y. 1987); *In re Storage Technology Corp. Sec. Litig.*, 630 F. Supp. 1072 (D. Colo. 1986); *Ahern v. Gaussoin*, 611 F. Supp. 1465 (D. Or. 1985); *Lewis v. Berry*, 101 F.R.D. 706 (W.D. Wash. 1984); *Summer v. Land & Leisure, Inc.*, 571 F. Supp. 380 (S.D. Fla. 1983); *Zatkin v. Primuth*, 551 F. Supp. 39 (S.D. Cal. 1982); *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 1314 (S.D.N.Y. 1982); *Seiffer v. Topsy's Int'l, Inc.*, 487 F. Supp. 653 (D. Kan. 1980).

[12] For example, the Ninth Circuit's rule would have likely precluded the granting of motions to dismiss in favor of defendant accounting firms in the following cases: *Latigo Ventures v. Laventhol & Horwath*, 876 F.2d 1322 (7th Cir. 1989) (where accountants performed audit and allegedly removed ominous qualification that financial results reported were subject to company's continuation as going concern); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987) (where American accounting firm supplied allegedly false information used by West German accounting firm in draft of audit report); *Oleck v. Fischer*, 623 F.2d 791 (2d Cir. 1980) (where accountants certified financial statements which plaintiff alleged gave false impressions through its descriptive lan-

Thus, the Ninth Circuit's conclusion that broad secondary liability is warranted here because "the cost to the accountant of disclosure is minimal" focuses on the wrong issue. *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d at 653 (Pet. 14a)). It is not the costs of disclosure that threaten to disrupt accounting and other professional services. Rather, it is the enormous liability costs resulting from the lower courts' increasing willingness to shift the responsibilities of disclosure away from management and onto the shoulders of accountants and other professionals. As demonstrated by the present case, that responsibility may be imposed regardless of the level of involvement or control that the professionals might reasonably be expected to exercise over the substance of the disclosures.

Given this expansive threat of liability, the costs of defense have become a significant part of the fees accountants must charge for their services. This cost, in essence, is a form of required insurance against the risk of the deal itself, and not against any conduct on the part of the accountant. The costs of professional insurance have also skyrocketed, requiring an increasing number of firms to self-insure or "go bare." As recently explained by one observer:

> Malpractice premiums have been rising, policy limits have been falling, and deductibles have been increasing. Some accountants have chosen to go bare, and

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guage); *Stevens v. Equidyne Extractive Indus., 1980 Petro/Coal Program 1*, 694 F. Supp. 1057 (S.D.N.Y. 1988) (where accountant's involvement was limited to issuance of pro forma projections and accountant did not issue opinion letter); *In re Gas Reclamation, Inc. Sec. Litig.*, 659 F. Supp. 493 (S.D.N.Y. 1987) (where accountants mailed two engagement letters to company and promised to provide future consulting and auditing services); *In re AM Int'l, Inc. Sec. Litig.*, 606 F. Supp. 600 (S.D.N.Y. 1985) (where accountants provided interim financial reports); *Beissinger v. Rockwood Computer Corp.*, 529 F. Supp. 770 (E.D. Pa. 1981) (where accountants certified without qualification financial statements which were used by company to prepare annual report which contained misstatements).

some insurers have refused to write coverage for accountants perceived as high risks.

Goldberg, *"Accountable Accountants: Is Third-Party Liability Necessary?"* 17 J. Legal Stud. 295, 295-296 (1988) (footnotes omitted). The defense and insurance costs of other professional services have similarly increased.

The effect of these higher costs on the economy are predictable: transactions requiring accounting services become more expensive and inevitably fewer. Accountants therefore find it less desirable to serve clients with new or untested business ideas. New ventures or ventures in speculative industries will find it increasingly difficult and costly to retain accountants. As a result, entrepreneurial ventures, including experimental or high-technology companies that are vital to the growth of the economy, may be impeded. *See* Minow, *Accountants' Liability and the Litigation Explosion*, 156 J. Acct. 80 (Sept. 1984).

3. Permitting Private Actions For Aiding And Abetting Will Burden The Courts And Subject Accountants And Other Professionals To Abusive Litigation.

Finally, the Ninth Circuit's decision underscores the vulnerability of accountants and other professionals to vexatious litigation. If the ruling is permitted to stand, Peat Marwick will be forced to incur the costs and burdens of defending itself, at least through the summary judgment stage, on the basis of plaintiffs' boilerplate, one-line averment that it "knew" the offering memoranda were false. As knowledge may always be averred generally, the lower court's decision arms plaintiffs with the *in terrorem* weapon of a securities class action against professionals, such as Peat Marwick, who are often assumed to have the "deep pockets" necessary to afford recovery—regardless of the degree of their culpability, if any, in the alleged fraud. This Court cautioned against just such a result in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. at 741:

> [T]o the extent that [this process] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a benefit.

The prospect of class action strike suits poses a particular threat when brought, as here, under Section 10(b), which lacks the procedural restrictions, such as an abbreviated statute of limitations and an allowance for the recovery of attorney's fees, provided for by Sections 9(e) and 18(a) of the 1934 Act.

The court below disregarded these concerns by adopting an expansive rule of secondary liability. The consequences of the Ninth Circuit's decision must be assessed not only in the isolated circumstances of this case, but in terms of all the cases to come. As noted in *Ernst & Ernst*:

> The class of persons eligible to benefit from such a standard, though small in this case, could be numbered in the thousands in other cases . . . . [W]e are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good.

425 U.S. at 214-216 n.33. Here, as there, "[a]cceptance of respondents' view would extend to new frontiers the 'hazards' of rendering expert advice under the [Securities] Acts, raising serious policy questions not yet addressed by Congress." *Id.* The decision below should be reviewed by this Court to ensure that the Congressional judgment as to the appropriate scope of liability under Section 10(b) and Rule 10b-5 is not supplanted to expose professionals to broad secondary liability under the 1934 Act that was never contemplated by Congress.

CONCLUSION

For the foregoing reasons, the Petition of Peat Marwick should be granted.

Respectfully submitted,

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Dated: October 23, 1989